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Addressing Major Water Resources Issues in Asia and the Near East Program: Philippines Program

Quarterly Report

January-March 2005

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Addressing Major Resources Issues in Asia and the Near East Program: Philippines Program

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The authors' views expressed in this publication do not necessarily reflect the views of the United States Agency for International Development or the United States Government.

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ACRONYMS

BAP	Bankers Association of the Philippines
CFA	Credit Framework Agreement
DBP	Development Bank of the Philippines
EO	Executive Order
FORWARD	Fostering Resolution of Water Resources Disputes
FS	Feasibility Study
GFI	Government Financial Institutions
GOP	Government of the Philippines
IRA	Internal Revenue Allotments
IRRs	Implementing Rules and Regulations
JBIC	Japan Bank for International Cooperation
LCP	League of Cities
LGU	Local Government Unit
LGUGC	Local Government Unit Guarantee Corporation
LMP	League of Municipalities
LWUA	Local Water Utilities Administration
MDGs	Millennium Development Goals
MFC	Municipal Finance Corporation
MOU	Memorandum of Understanding
MTPDP	Medium Term Philippine Development Plan
MWLFI	Municipal Water Loan Financing Initiative
NAPC	National Anti-Poverty Commission
NEDA	National Economic Development Authority
NWRB	National Water Resources Board
O&M	Operation and Maintenance
ODA	Overseas Development Assistance
PAWD	Philippine Association of Water Districts
PFI	Private Financial Institutions
PNB	Philippine National Bank
PWRF	Philippine Water Revolving Fund

SOW	Scope of Work
TO	Task Order
USAID	United States Agency for International Development
WB	World Bank
WD	Water District
WSP	Water Service Providers

SUMMARY OF RESULTS

USAID MISSION GOAL :

Enhanced security, governance and capacities for sustainable, equitable economic growth.

STRATEGIC OBJECTIVE #4:

Management of productive, life sustaining natural resources strengthened.

INTERMEDIATE RESULT 1.2:

Urban environmental management improved.

FORWARD Philippines Targets in support of IR 1.2

1. Technical assistance to improve the management and operating practices of selected utility/ies is leading to efficient and sustainable operations
2. At least one project funded under the Municipal Water Loan Financing Initiative (MWLFI)
3. Feasibility Assessment of establishing a Philippine Water Revolving Fund

Achievements to Date

* Postponed. TA will be provided to one utility that will access the MWLFI

Assisted with the marketing of the MWLFI, identification of candidate utilities and initial review of proposed projects.

Feasibility assessment drafted and submitted to USAID/Philippines for comments.

CHAPTER ONE: SUMMARY OF PROJECT OBJECTIVES AND RESULTS

A. PROJECT OBJECTIVES

The project's work program has evolved significantly during the last quarter of 2004. Activities were re-prioritized to support two Memoranda of Understanding (MOU) between USAID and the Japan Bank for International Cooperation (JBIC) that were signed on October 12, 2004. The first MOU includes the Development Bank of the Philippines (DBP) and the Local Government Unit Guarantee Corporation (LGUGC) and resulted in the design of the Municipal Water Loan Financing Initiative (MWFLI). The second MOU includes only the DBP and focuses on the establishment of a Water Revolving Fund (WRF). Both of these MOUs resulted from the *Clean Water for People Initiative*, a joint endeavor between the USA and Japan Governments to provide safe water supply and sanitation to the world's poor, among other objectives.

Based on discussions with USAID/Philippines, we redirected the FORWARD Philippines Project to:

- Support the implementation of MWFLI by providing technical assistance in identifying, reviewing and packaging projects, and by helping build project appraisal capability for water projects in the LGUGC and DBP. The MWFLI is administered by the Development Bank of the Philippines (DBP), with initial funding provided by JBIC through their Environmental Infrastructure Support Credit Program I. The DBP and LGUGC committed to mobilizing a 30-50% private sector match to the JBIC funding.
- Conduct a feasibility analysis for a longer term lending facility, a water revolving fund (WRF) to meet the investment requirements of water utilities in the Philippines.

In March 2005, the work plan evolved further to include supporting the preparation of a Credit Framework Agreement (CFA) for the WRF. The CFA will define: the structure of the WRF; its capitalization; delineate responsibilities among the concerned parties; extent of obligations, rights and privileges; and the administration of the Fund. The decision on how to support the preparation of the CFA is still pending with the USAID/Philippines mission.

B. REVISED TARGETS

- At least one project financed under the MWFLI
- Completed feasibility assessment a WRF, consisting of analysis of the demand for such a facility; the policy, governance and institutional constraints, and recommendation of options for a WRF design and mechanism.
- Draft credit framework agreement for the WRF.

C. OVERVIEW AT THE END OF THE QUARTER (JANUARY- MARCH 2005)

Work during the reporting quarter period focused on preparing the feasibility assessment of the Philippine water revolving fund and marketing the MWLFI to Iligan City, which had indicated interest to tap the facility for its water supply rehabilitation and expansion project.

PHILIPPINE WATER REVOLVING FUND ACTIVITIES

- *Conducted consultations with key stakeholders in the water sector on the WRF.* The project team conducted key informant interviews and focused group discussions on the WRF design options with representatives from the government (DOF, NEDA, MFC, LWUA, NAPC, and NWRB), the private sector, water district association, and the Leagues of Cities and Municipalities.
- *Conducted a consultative workshop on the water revolving fund options.* The team organized and facilitated a workshop among key stakeholders to discuss collectively the objective, design principles and options for structuring a water revolving fund.
- *Prepared the draft of the WRF feasibility assessment.* The team prepared the PWRF feasibility assessment and submitted the first draft to USAID/Philippines March 15, 2005. The draft report was also given by USAID to JBIC/Philippines for its comments.
- *Prepared the Memorandum of Agreement to organize the Steering Committee for the WRF.* The team, in consultation with USAID and JBIC, drafted a Memorandum of Understanding between the DOF, NEDA, BAP, JBIC and USAID to organize a steering committee to oversee the development of the WRF. The MOU defines the terms of reference for the Steering Committee to prepare a Credit Framework Agreement.

MUNICIPAL WATER LOAN FINANCING INITIATIVE

Prepared the Scope of Work of the Technical Assistance to Iligan City Waterworks System. The team prepared the SOW for technical assistance to improve utility management and operating systems. FORWARD technical assistance is conditioned on the City's borrowing funds from the MWLFI. The team also participated in the MWLFI Technical Working Group effort to prepare a credit financing structure that will lower the City's cost of borrowing funds from the MWLFI.

CHAPTER TWO: PROGRESS TO DATE BASED ON RESULTS INDICATORS

TASK 1: HELPING LGUS/WATER DISTRICTS RESTRUCTURE OPERATIONS TO IMPROVE OVERALL FINANCIAL STATUS AND OPERATIONAL AND FINANCIAL EFFICIENCY IN THE DELIVERY OF WATER AND WASTEWATER SERVICES

The team planned to select and work with four to six of the better managed LGUs and/or water districts to carry out a set of activities that would strengthen management, and improve operations and finances.

Status: Based on agreement with USAID/Philippines, the team realigned its budget to support the new Task 3, Feasibility assessment of the WRF. In view of this realignment, we have deferred all activities under Task 1 except for possibly one pilot project linked to the implementation of the MWLFI (Task 2).

TASK 2: IMPROVING LGU/WATER DISTRICT ACCESS TO CREDIT FINANCING FOR NEW WATER/WASTEWATER PROJECTS

The work focuses on the provision of technical assistance to the USAID-JBIC Municipal Water Finance Loan Initiative (MWFLI), particularly to the Development Bank of the Philippines (DBP) and the Local Government Unit Guarantee Corporation (LGUGC). The FORWARD-Philippines team was asked to provide the following assistance:

- Help draft criteria, procedures and operating guidelines, and project appraisal tools (e.g., appraisal checklist, financial due diligence benchmarks, financial models) for the evaluation of projects and issuance of loans under the MWFLI.
- Related to the appraisal tools, prepare an excel-based financial analysis model that will enable the lender to validate the financial indicators of projects using more refined financing terms and conditions following that of the MWFLI.
- Help prepare water utility financial performance benchmarks to enable the lending institution evaluate the overall health and soundness of a utility's operation thereby establishing its bankability.
- Help the LGUGC draft an information memorandum on the MWFLI.
- Help review project studies and overall financial performance of candidate water utilities.
- Facilitate negotiations between Water Districts and/or LGUs, LGUGC and DBP on at least one or two loans for water and/or sanitation projects.
- Throughout the term of the Task Order, identify policy, regulatory and procedural issues, prioritize these in terms of impact and potential solutions, and describe the actions required by different institutions to mobilize private sector capital for water/sanitation infrastructure financing.

Based on agreement with USAID/Philippines, we scaled back Task 2 during the realignment of project resources and focused most efforts on Task 3. The team will continue to help the MWLFI Technical Working Group to identify and evaluate projects, prepare information memoranda on the project, and facilitate negotiations between the utility, DBP and LGUGC.

Status: The MWLFI Technical Working Group pursued discussion with two potential borrowers:

- ***Iligan City Government.*** Iligan City has a PhP 500 million water supply improvement project, which includes bulk water supply and distribution system expansion. The project is a flagship project of the current administration. Following the initial marketing presentation to the City Mayor, the technical working group met with the City Council (Sanggunian) on February 1, 2005 to give them a more detailed briefing on the terms and conditions of the loan (See Annex 2 on the highlights of the discussion). The City Council reiterated the city's interest but remained non-committal. To encourage the City to access the MWLFI, the DBP agreed to improve the loan terms. The new terms offer two options for private sector financing: one through a direct loan and the other through a bond float. DBP also lowered the interest rate to 8.5% and offered to extend loan tenors from 15 to 18 years.
- ***Metro Leyte Water District.*** This large water district has an immediate investment requirement of PhP 80 million to annex a new area to its system. However its medium term program has a total requirement of about PhP 1 billion. The team presented the MWLFI lending terms to the water district's general manager who expressed interest. The next step is to present the facility to the Board, which will ultimately decide on whether to borrow funds from the MWLFI.

Other possibilities include: Metro Cebu, with a PhP635 refinancing loan application with DBP and a PhP800M project in the pipeline, Sta. Rosa, Pagadian (PhP80M), Zamboanga (PhP 150M), Baguio (PhP160M), Tagum (PhP 150M), and Calapan (PhP 180M).

TASK 3: FEASIBILITY ASSESSMENT OF A WATER REVOLVING FUND

The scope of the feasibility assessment includes:

- Establishing the level of demand for water financing
- Identifying issues related to governance, financing and institutional framework and recommending measures to address these issues.
- Identifying viable options for a Water Revolving Fund (WRF) drawing upon lessons learned from the experiences in the US, India, South Africa, and Mexico.

STATUS

FORWARD organized a video conference on January 7, 2005 to present eight options for structuring a water revolving fund. Representatives from the Department of Finance, National Economic and Development Authority, Local Water Utilities Administration and the Municipal Finance Corporation, and USAID, JBIC, DBP and LGUGC attended the conference. Based on the video conference discussions, the team eliminated three options because they did not involve private financing institutions and ODA funds. See Annex 3 for the revised draft of the presentation material showing the five options.

Between mid January and mid February, the team reviewed the five options with representatives from the DOF, NEDA, Local Water Utilities Administration (LWUA), Municipal Finance Corporation (MFC), Philippine National Bank - a private financing institution (PFI), League of Cities of the Philippines, League of Municipalities of the Philippines, Philippine Association of Water Districts, the National Water Resources Board, and the National Anti-Poverty Commission. These consultations confirmed the general interest in establishing a sustainable financing mechanism for water projects. The DOF and NEDA did not rule out the possibility of a national government grant to help capitalize a WRF reserve account, but agreed that it would be difficult this year or next given the government's fiscal constraints. The MFC and LWUA expressed interest in "hosting" the WRF, and

willingness to provide seed capital resources to the Fund. Water utilities raised concerns about the affordability of borrowing rates, reasonableness of collateral requirements and loan tenors, preferring 20-25 year repayment periods. The PFI expressed their concerns with credit and term risk, but agreed that a guarantee provided by LGUGC and backed by USAID's Development Credit Authority would encourage their participation, although not lead to a lowering of interest rates or longer loan tenors beyond seven years.

On February 14, 2005, the team conducted a workshop to collectively discuss the issues and reach agreement on the next steps. See Annex 4 for the summary of proceedings. The workshop validated the need for a sustainable and innovative financing mechanism for water projects. Although the participants did not select one "best" option for a revolving fund, they agreed to create a high-level steering committee to develop a credit framework agreement that will define the basic principals, organization and administration of a revolving fund. The Steering Committee consists of DOF and NEDA, Bankers Association of the Philippines, USAID and JBIC. The FORWARD team drafted a Memorandum of Understanding to create the Steering Committee (see Annex 5). The MOU is being reviewed by the SC members. The first meeting is scheduled for early April.

In addition to the Steering Committee, the workshop participants also agreed to create a Consultative Group, consisting of other key stakeholders in the sector to serve as the sounding board of the Steering Committee. Members of the Consultative Group include: National Anti-Poverty Commission, Government Financing Institutions, Local Government Unit Guarantee Corporation, Department of Interior and Local Government, League of Municipalities in the Philippines, League of Cities in the Philippines, Cooperative Development Authority, Local Water Utilities Administration, Philippine Association of Water Districts and the National Water Resources Board.

On March 15, 2005, the study team submitted to USAID/Philippines a draft Feasibility Assessment for the Philippine Water Revolving Fund. The report provides an overview of the water sector situation, an assessment of policy, institutional and financing issues and recommendations to address these issues, a review of financing gaps with projections from 2005 to 2015, and an in depth discussion of the design options to structure the fund and the next steps toward establishing the fund. The Mission shared the report with JBIC. The FORWARD team has now received comments from USAID and JBIC and will be finalize the report by late April/early May.

Developing a Credit Framework Agreement (CFA) builds on the WRF feasibility assessment and serves as a more in-depth analysis and detailed design. The CFA will answer the following key questions:

- Capitalization of the WRF: Where will the money for the WRF come from? How will the Fund be capitalized? Will the Government provide sovereign guarantees to donor loans that help capitalize the WRF?
- Ownership and Management of Fund: Who will administer the Fund? What guidelines will govern the Fund's management? Note that the WRF can have multiple windows with different terms. For example there could be a revolving fund with zero interest loans to some poorer communities. You can have different categories of beneficiaries of the WRF rationalized by their capacity or ability to pay.
- Operating Procedures: How will the Fund receive projects, evaluate and approve projects, disburse funds, and monitor project implementation?
- Credit enhancement mechanisms: Where will the funds for credit enhancements come from?

- Reserve Account: How will it be capitalized - source of funds and how much? Note, the size of the reserve account will define the level of funding that can be attracted from the private sector and the overall size of the loan portfolio that can be developed by the Fund.
- Lending Terms: What will be the lending terms and conditions, and the underwriting criteria of the WRF?
- Technical Implementation: Who will provide technical support?

ISSUES

- The project's budget is insufficient to complete all the *next steps* to the credit framework agreement. The project has realigned its budget to support many of the next steps for preparing the credit framework agreement, but more funding is needed to finalize this work.
- Completing the credit framework agreement will maintain USAID's leadership in creative water sector financing, and provide the Philippine government the information it needs to approve the Fund.

NEXT STEPS/TARGETS FOR NEXT QUARTER

- Finalize the feasibility assessment report.
- Subcontract for specialized expertise to advise the GOP on drafting the Credit Framework Agreement.
- Work with the Steering Committee to draft the Credit Framework Agreement.
- Help the Steering Committee present the CFA to the WRF Consultative Group.
- Assist in the review of projects for the MWLFI.
- Subject to Iligan City's decision to borrow funds from the MWLFI, commence with the technical assistance for management system improvement.

CHAPTER THREE: USE OF FUNDS DURING THE QUARTER

Contract Component	Budget	Expenditures (3/30/2005)	Funds Remaining
Labor	\$338,063	\$155,664	\$182,399
Travel and ODCs (under Other Direct Costs)	\$195,672	\$43,083	\$152,589
G&A	\$16,045	\$5,773	\$10,272
Total	\$549,780	\$204,520	\$345,260

Includes both actual and accrued costs through March 31, 2005.

CHAPTER FOUR: CONTRACT DELIVERABLES

Deliverable	Date
Working Paper: Analysis of Constraints to Mobilizing Private Sector Financing for Water Supply and Sanitation Projects in the Philippines	September, 2004
Working Paper: Financial Performance Evaluation of Selected Water Districts and Local Government Units	December, 2004
Working Paper: Financing Options. Water Revolving Fund Initiative in the Philippines	January, 2005
Summary of Proceedings: Workshop on Structuring Options for a Water Revolving Fund in the Philippines	February, 2005

CHAPTER FIVE: LEVEL OF EFFORT IN PERSON-DAYS

Position	Name	LOE	LOE used to date	LOE used during the quarter
A. US Professionals				
Program Coordinator ¹	Del McCluskey	230	90.4	20.4
Information/ Data Management	Tami Fries	4	1	0
Financing Advisor	Brad Johnson	53.5	38.5	26
B. Cooperating / Third Country Nationals				
Philippines Program Director	Alma Porciuncula	392	124	66
Philippine Banking Specialist	Hector Florento	85	85	0
Water Utility Accounting and Finance Specialist	David Roco	57	57	0

¹ Time for Del McCluskey is charged to the FORWARD Program Management and not to the Philippines Task Order.

ANNEX 1: SCOPE OF WORK OF THE TECHNICAL ASSISTANCE TO THE ILIGAN WATERWORKS UTILITY

BACKGROUND

The Municipal Water Loan Financing Initiative (MWFLI) was established as a pilot financing mechanism for water and sanitation projects involving private financing institution's participation. The MWFLI was marketed in November 2004 in Mindanao. One of the water utilities approached was Iligan City, which operates its own water utility, through the Iligan City Waterworks Services (ICWS).

ICWS currently serves 47% of the city's population and wanted to increase it to 60% 2003 and to 80% by 2015. Based on 2001 Feasibility it was determined that ICWS need additional bulk water capacity and expansion of the distribution network. The estimated total investment requirement was at Php 500 million in 2001 prices.

In the November meeting with the Iligan City chief executive, Mayor Lawrence Lluch Cruz expressed interest on the MWFLI. He organized a Task Force that would review the water project vis-à-vis the MWFLI. The Mayor reconfirmed his interest to tap the MWFLI in January 2005 but requested for technical assistance to improve the management of the water system.

The FORWARD technical assistance on capacity building will complement the project development effort of Iligan City.

OBJECTIVES

The objectives of the technical assistance are:

- Conduct a performance audit on the water utility to assess strengths, weaknesses and priority capacity building interventions
- Recommend a program for financial management improvement
- Recommend a program for technical improvements
- Facilitate public hearing on tariff increase

SCOPE OF WORK

- Review the operations of the water utility and evaluate its financial and technical performance.
- Conduct a needs assessment on financial management and technical improvements, as well as training requirements for staff.
- Review and evaluate the adequacy and effectiveness of the current financial system.
- Recommend a financial management program that will:
 - Establish a separate account for the water utility investments and operations
 - Establish a financial monitoring and control systems
 - Establish a rationalized tariff setting model
- Review and evaluate soundness and efficiency of operation and maintenance practices.
- Recommend a technical program that will:

- Reduce non-revenue water
- Improve billing and revenue collection
- Improve use of staff in service delivery
- Reduce cost of operations
- Strengthen overall management operations
- Plans for each water utility or water district will incorporate specific performance benchmarks for operational and financial improvements to be achieved as a result of the assistance, and the timeframe for meeting these benchmarks.
- Facilitate public hearing on tariff increase

SCHEDULE

Performance Audit Report	End of Week 1
Interim Report	End of Week 3
Final Report	End of Week 5

RESOURCES

Position	LOE
Financial Specialist	30 days
Water utility management technical specialist	30 days

ANNEX 2: HIGHLIGHTS OF THE MEETING WITH ILIGAN SANGGUNIANG BAYAN ON THE MWLFI

Participants:

MWLFI Team

Aurora Maghirang	DBP
Popo Diloy	DBP
Khaye Cervantes	DBP
Neogen Chavez	DBP Iligan
Rolando Baliog	DBP Iligan
Heidi Capampangan	DBP CdO
Ramon Abracosa	DBP Consultant
Marissa David	DBP Consultant
Benjie Laza	LGUGC
Alma Porciuncula	FORWARD/ USAID

Iligan City

Lawrence Cruz	Mayor
Henry Dy	Vice-Mayor
Orlando Maglinao	Councilor
Rudy Manzo	Councilor
Voltaire Rovira	Councilor
Wilfredo Bacuran	Councilor
Alfredo Busico	Councilor
Benny Madelles	Councilor
Cornelio Israel	ICWS Manager
Jaime Sato	ICWS Engineer
Alfredo Primero	NGO

PNB Representatives

Archie Inabangan	PNB Main
Robert Chica	PNB Region
Jacinto Jacinto	PNB Region
Mr. Lugtu	PNB Iligan
Mr. Cuevas	PNB Iligan Branch Manager

1. Engineer Sato presented the Iligan City Waterworks System² development project, designed to meet the requirements from 2005-2020. The ICWS Master Plan was prepared in 1997, from which BCEOM (for WB's LGU Urban Water and Sanitation Project) identified a project scope and conducted therefor a feasibility study in 2000. In August 2004, ICWS reviewed the Master Plan and updated the cost estimates of the project, currently estimated at Php 844 million. The project components include: additional bulk water supply, installation of transmission pipes, and rehabilitation of existing pipes and expansion of the distribution network. See Table 1 for the breakdown of cost estimates.

Table 1: Project Cost Estimates

1. Direct and Indirect Cost	South Php (000)	North Php (000)
• Production	9,178	
• Transmission Lines	245,238	69,500
• Reservoirs	101,843	31,335
• Distribution Lines	124,599	65,688
• Rehabilitation of Pipes	54,338	7,815
• Reticulation	36,000	10,800
• Miscellaneous	5,952	4,222
Subtotal	571,148	189,360
2. Government Reserves and Contingency	57,715	18,936
Total	634,863	208,296
Grand Total (North+South)	Php 844,000	

² ICWS is operated as a unit of the City Government and as such relies on the Local Legislative Body for its policy direction as well as regulation of water rates. It has a distinct organizational structure but has no separate accounting and financial management system.

1. The project targets service provision from 28 to 32 barangays, and from a population of 251,195 to 346,218. This represents 80% connection coverage (from an official count of 47%). Complementing the investment program are programs to reduce the NRW from 57% to 30% and metering coverage from 70 to 100%.

There was no mention however of tariff adjustments. The current tariffs are at:

Ranges	Residential (Php)	Commercial (Php)	Industrial (Php)
Min. (1 st 10 m3)	20.00	40.00	192.00
11-20 m3	2.30	4.60	6.90
21-30 m3	2.80	5.60	8.40
31-40 m3	3.40	6.80	10.20
41-50m3	4.10	8.20	12.30
Above 50	5.00	10.00	15.00

2. The presentation of ICWS was followed by the presentation of the MWLFI by Mr. Laza.
3. Questions/ issues raised by Sanggunian members and responses thereto are as follows:

- | | |
|---|--|
| a) Can the city avail of just the DBP component? PFI terms are stiff. | <p>DBP- No MWLFI is specifically designed to combine the JBIC loan with a PFI counterpart.</p> <p>The PFI share may be reduced to say 40% to increase the “soft” component of the loan.</p> |
| b) What happened to the previous option of a 9% fix interest rate and 15 year tenor | <p>DBP- This was the WB facility, which presently is no longer available. At the moment DBP cannot offer an alternative to the MWLFI. It is the only facility available for water project financing</p> |
| c) Will there be conditionalities to the loan, i.e., tariff increase or commercial operation? | <p>DBP- There will be no conditionalities; however we recommend that tariffs should at least cover O&M costs. Also, the city will not be required to get a private operator under a lease contract as required by the WB loan.</p> |
| d) Will there be a hold out of the IRA equivalent to the total project cost? | <p>DBP- The IRA assignment will be equivalent to the amortization and not the entire project cost. Relatedly the City will be required to use DBP as its depository bank.</p> |
| e) Will 10% equity be required of | <p>LGUGC- There will be no equity requirement. The DBP component effectively funds the</p> |

- | | |
|---|--|
| the City? | The PFI component effectively funds the equity as required by the JBIC loan. |
| f) How much will be the add on cost for financial advisory/ | LGUGC – Unlike in the case of bonds, no FA fee will be charged. |
| g) Can't USAID provide a capital grant similar to what is being provided in some areas in Mindanao? | <p>FORWARD- There is no possibility of a capital grant. USAID through FORWARD is however committing technical assistance resources, in the event that the City decides to tap the MWLFI, to help ICWS conduct a performance audit and needs assessment; prepare a program for financial and technical systems management improvements, and facilitation of a public hearing on tariff adjustment. The TA is not a regular value added proposition for the loan but since Iligan is hopefully the first client, the team would like to have a demonstration project that would show the impact of a comprehensive development program.</p> <p>A copy of the draft SOW was given to the City representatives.</p> <p>Later the Mayor assigned the ICWS Manager to coordinate with the team to finalize the SOW and work out the arrangements for the implementation of the TA.</p> |
-
4. After the Q&A, the Mayor gave his closing/next steps remarks. He said it may appear that there is no buy in yet. But he assures the group that significant headway has been achieved in terms of getting a consensus on the implementation of the water project. There is a clear agreement to implement the project within the term of the current administration. They have agreed to a deadline of July 2005 to complete all the necessary steps to commence the implementation [including impliedly financial closure]. He said he will discuss further with DBP the details of the financing package.

 5. Finally the Vice Mayor who heads the local legislative body that is the approving body for the investment program and financing (it has to give the Mayor the authorization to sign the loan for and in behalf of the City Government) assured the group that there is solid support behind the programs of the Mayor, especially for the water project, which has been declared his flagship project.

Conclusion:

The City did not give an explicit position on whether it is or not pursuing the MWLFI. Based on the exchange alone, it is difficult to ascertain the interest of the City officials. A lot of posturing from the opposition councilors was noted. However, based on discussions on the side, it can be surmised that the MWLFI is being seriously considered. Of paramount concern is the implementation of the project within the year, and MWLFI has been presented as immediately accessible. The presence of PNB has also I think assured them that there is a willing and ready PFI counterpart.

ANNEX 3: OPTIONS FOR THE PHILIPPINE WATER REVOLVING FUND

The interest in a WRF is driven by a number of challenges. These include the lack of available funds from the National Government, inability of local water providers outside of Metro Manila to obtain private sector financing, unsustainable financing programs administered by GFIs. Moreover current credit programs are not rationalized, do not leverage private financing and because they are ODA-funded they increase foreign exchange exposure of the government.

POLICY FRAMEWORK

The National Government has put out mandates regarding the water sector that are inconsistent with its goals:

- Executive Order (EO) 279 requires creditworthy water districts (WDs) to secure financing from private sector with interest rates above existing GFI financing.
- National Government wants to keep water tariffs affordable.
- The Local Government Code devolves water and sanitation responsibility to local government units (LGUs) but provides no added funding beyond LGU internal revenue allotment (IRA).
- Leveraging private sector funding will reduce but not eliminate need for government resources.
- National Government wants to eliminate sovereign guarantees for water/sanitation structure.

To achieve the twin objective of mobilizing private capital and at the same time ensuring affordability of rates private capital must be combined with low cost public funds. This is the principle behind the WRF. The WRF is established in several countries to leverage private sector investments in local water projects. It was set up where public funds are not sufficient to meet local water infrastructure needs.

In the US, the WRF relies on annual capitalization grants from the national government that are used to leverage private investments. This brings us to the question, “Is the Philippine government willing to make annual commitments of funds to capitalize a WRF?” If yes, what institution or government agency will provide the funding and be selected to manage the WRF? If no, are there other existing resources available that may be utilized to capitalize a WRF? If these resources flow from an existing program or GFI, is that program or GFI capable of managing a WRF?

WRF OPTIONS

The main considerations for identifying the options are: revolving nature of the fund, leveraging of PFI resources, and affordability of interest rate and tenor. The latter cannot be overemphasized. The tables below illustrate why lowering the cost and lengthening the tenor is key to generating real demand among utilities.

TABLE 1: IMPACT OF INTEREST RATES & TERMS ON LGU BORROWING CAPACITY

Scenario	Term (7 years)	Interest Rate	Annual Debt Service Cap. (PhP M)	Total Loan (PhP M)
A	7	15%	56	159
B	15	13%	56	268
C	15	8%	56	354

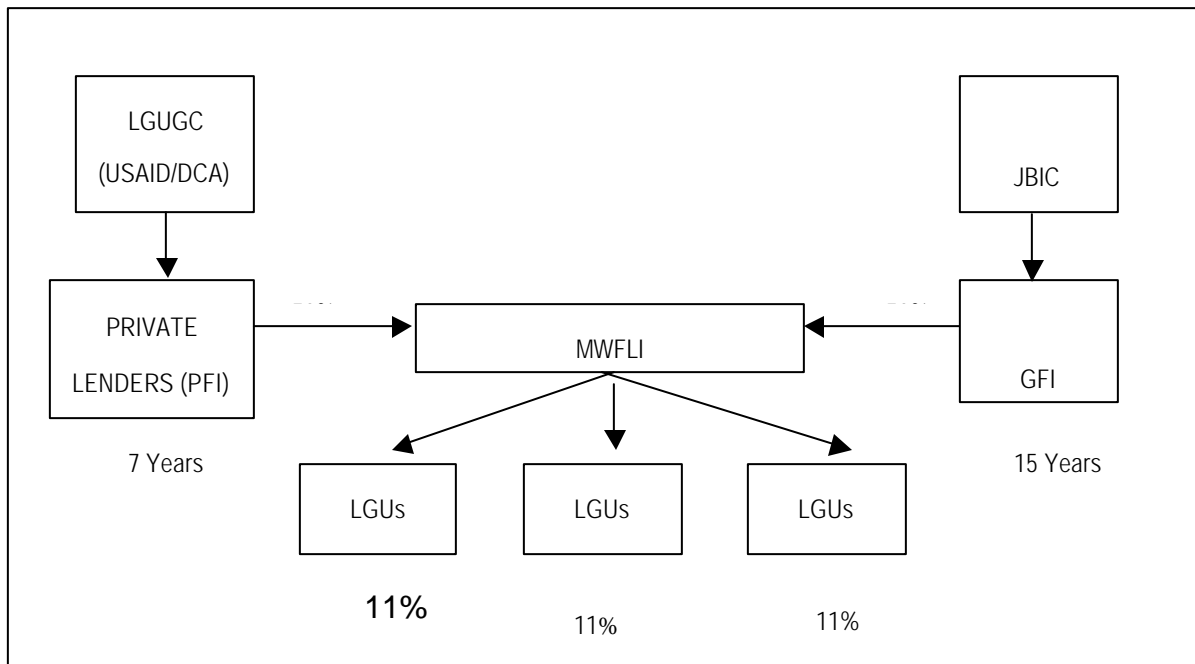
Using the average annual borrowing capacity of LGUs, estimated at PhP 56 million (M), note the size of project that can be financed if the interest rates are reduced and tenors lengthened.

TABLE 2: COMPARATIVE DEBT SERVICE TABLE ON PHP100 MILLION

Term (no. of years)	Interest Rate	Annual Payment (PhP M)	Total Payment (PhP M)
7	13%	21.8	152.8
7	8%	18.7	130.9
7	6%	17.5	122.7
15	13%	15.2	227.7
15	8%	11.5	172.0
15	6%	10.1	151.9

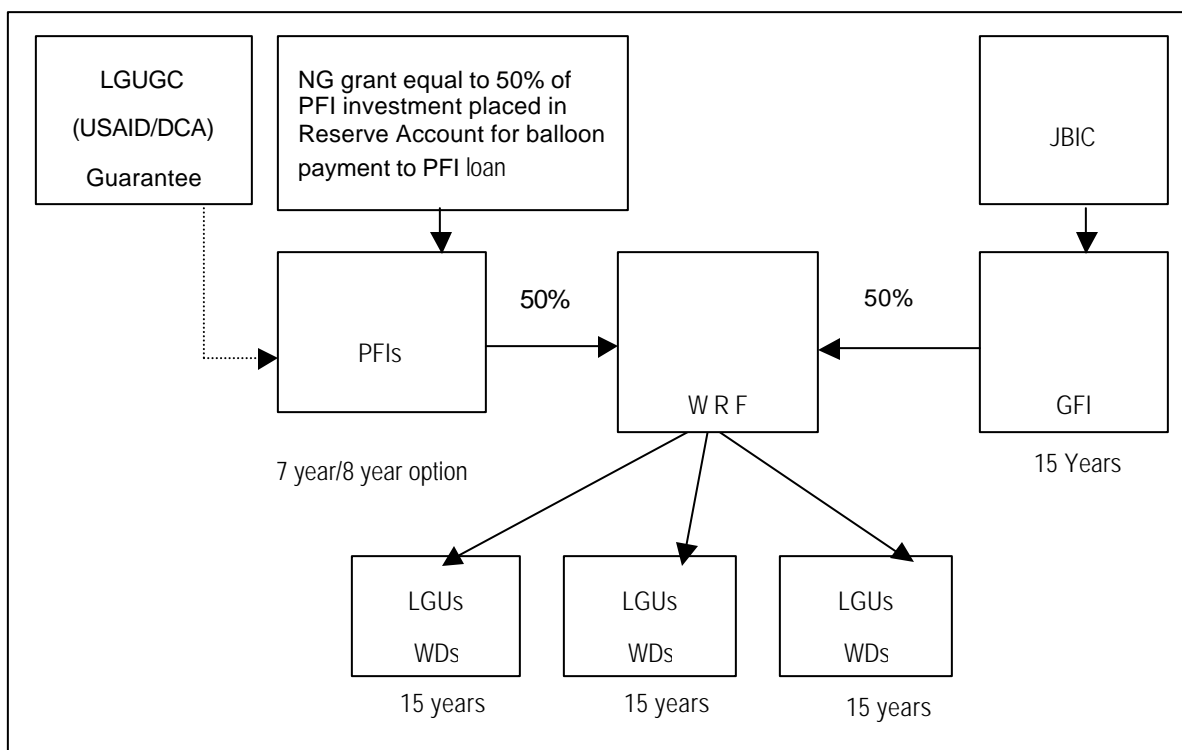
Another way of looking at it, the above table illustrates the impact of interest rates and loan tenors on annual payments.

OPTION 1: MUNICIPAL WATER LOAN FINANCING INITIATIVE (MWFLI) MODEL



Option 1 requires a sovereign loan and guarantee but needs no contribution from the Philippine government (GOP). It has a blended interest rate of 11% and a potential loan volume of PhP 2 billion (B) on the first year through Year 15. The estimated annual debt service to be paid on Yr 3 is PhP 500M. However, this WRF model is difficult to structure since capitalization is based on funds with different maturities (7 years for the PFI and 15 years for the GFI). Also, it is not a revolving fund.

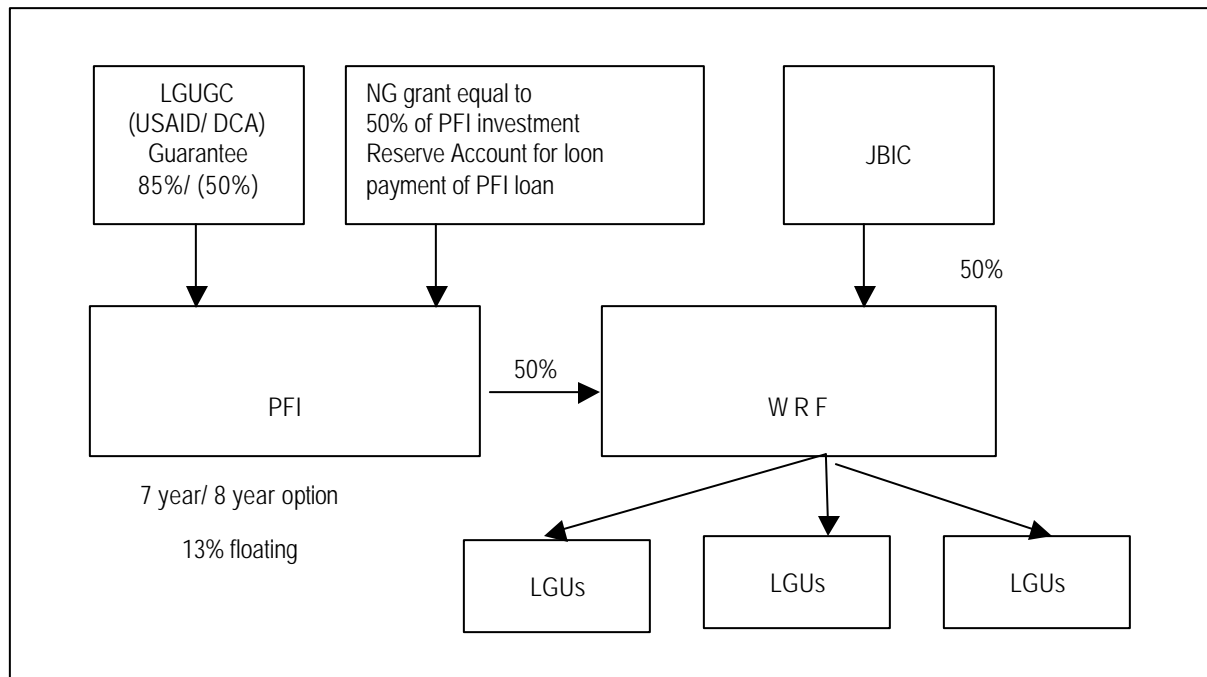
OPTION 2: GRANT RESERVE FUND MODEL



In Option 2, loans from the private financial institutions (PFIs) are amortized over 15 years. PFIs will be given the option to get out on the 7th year, in which case a balloon payment is made for the remainder of the loan and the WRF would execute an eight-year loan with the utilities. The balloon payment will be sourced from a reserve account. The reserve account would earn 8% interest over first 7-year period and beyond if PFIs renew the loan.

Option 2 requires a sovereign loan and guarantee and a GOP grant contribution of PhP 1B. The blended interest rate is 11% and potential loan volume on Yr 1 is PhP 4B growing to PhP 9.5B by Yr 15. The estimated annual debt service on Yr 3 is PhP 750M.

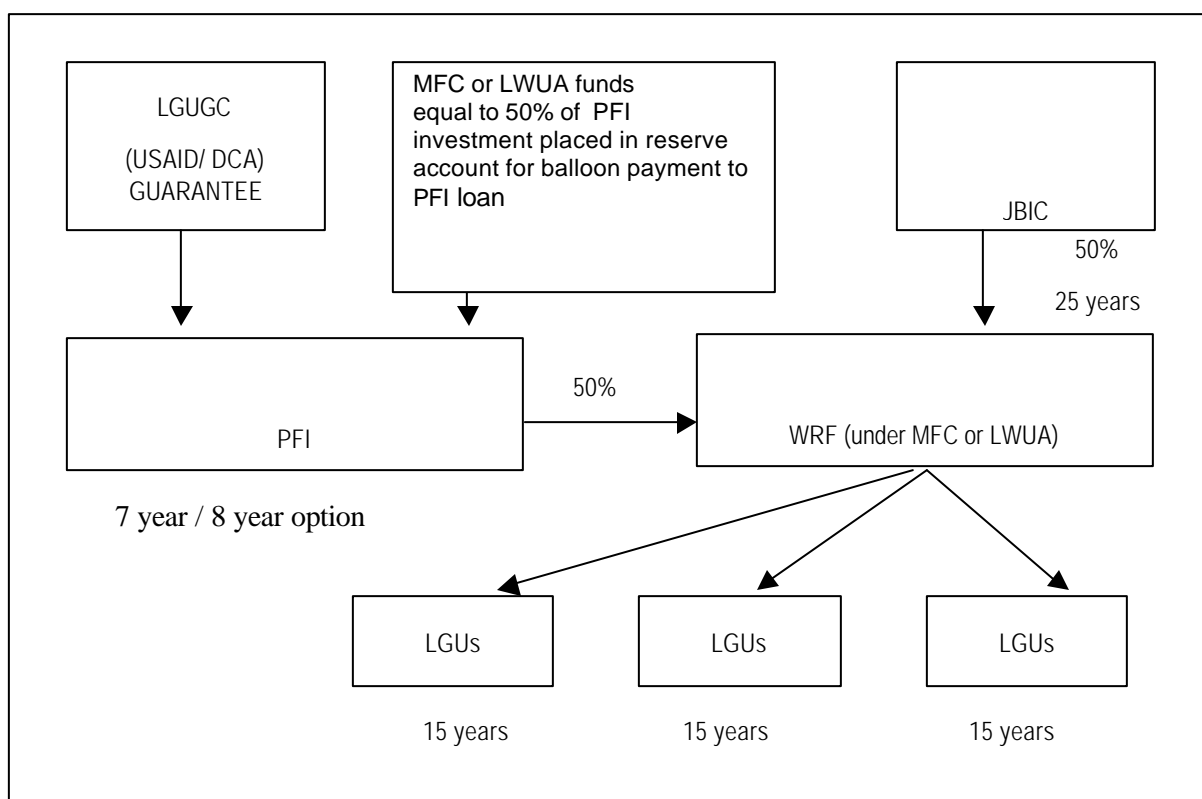
OPTION 3: JBIC DIRECT LOAN TO THE WRF MODEL



The cost of borrowing for LGUs and WDs based on JBIC direct loan to WRF is lower in this option compared to the previous options. The blended interest rate is only 9.5% as opposed to 11% in Options 1 and 2. Option 3 has the same balloon payment and re-loan from reserve accounts as in Option 2, the Grant Reserve Fund Model.

Again, there is a sovereign loan and guarantee required and a NG grant contribution of PhP 1B. The potential loan volume is PhP 4B on Yr 1 and PhP 15.4B on Yr 15. The estimated annual debt service on Yr 3 is PhP 690M.

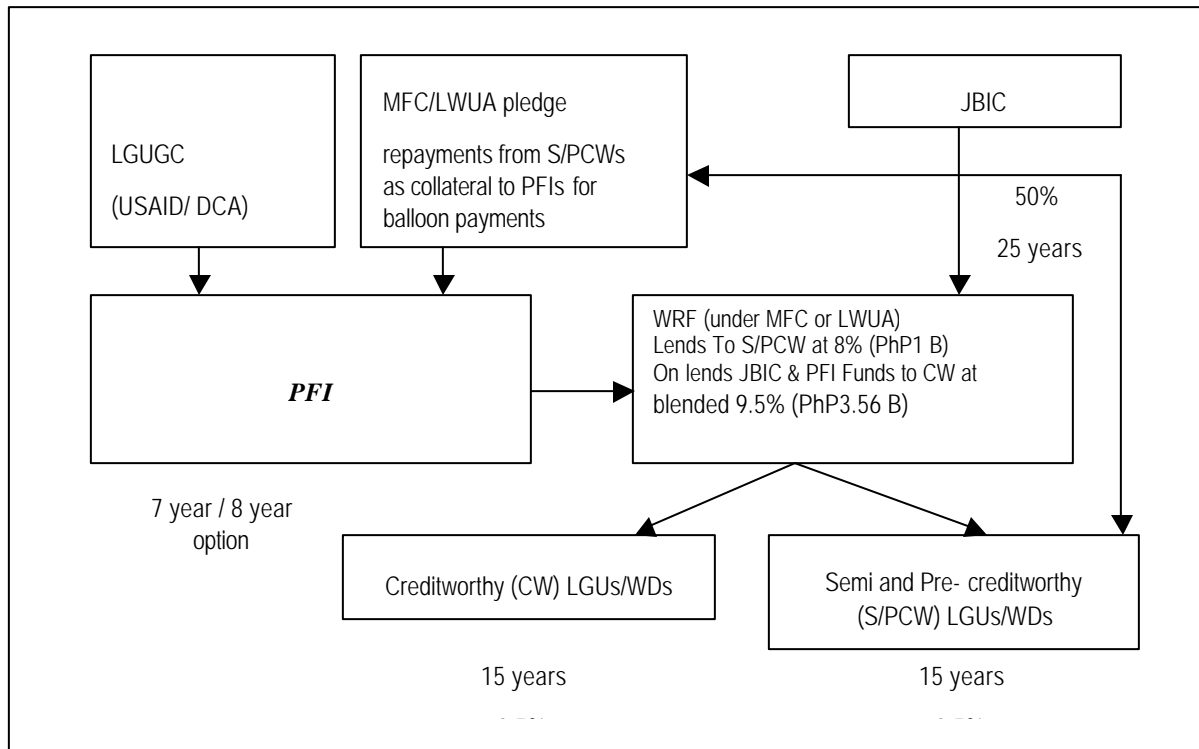
OPTION 4: JBIC/MFC OR LWUA/PFI MODEL



In Option 4, the Municipal Financing Corporation (MFC) or the Local Water Utilities Association (LWUA) would set aside reserves equal to 50% of private sector contribution. Reserves are pledged for balloon payment to PFIs. Reserves earn interest that is used to credit enhance other projects. Balloon payment structure is the same as in Grant Reserve Fund Model.

As in Option 3, this option requires a sovereign loan and loan guarantee. The NG grant contribution of PhP 1 B would be comprised of existing reserves from the MFC and/or LWUA. The potential loan volume is PhP 4B on Yr 1 and PhP 15.4B on Yr 15. The estimated annual debt service on Yr 3 is PhP 690M.

OPTION 5: PFI/JBIC/MFC OR LWUA MODEL



In this model, the WRF channels PFI and JBIC funds to the creditworthy LGUs and WDs at a blended interest rate of 9.5%. The MFC/LWUA funds are used to lend to the semi and pre-creditworthy (S/PCW) water service providers at 8%. The MFC/LWUA pledges loan repayments from S/PCWs to PFIs as collateral for balloon payments in Yr 8 to allow for the 15-yr financing out of the PFI funds.

As in all the other options, a sovereign loan and guarantee is required and an MFC/LWUA contribution of PhP 1B. The blended interest rate is still at 9.5% and potential loan volume in Yr 1 at PhP 4.6B, and PhP 13.5B in Yr 15. The estimated annual debt service on Yr 3 is PhP 690M.

SUMMARY OF OPTIONS

Option 1 is excluded since it does not meet the objectives of a water revolving fund. With Options 2, 3, 4, and 5, you see different leveraging ratios, different interest rates, and different annual debt service payments.

Option	Total Loan funds (Yr 1 in billions)	Loan Funds (Yr 15 in billions)	Leverage	Blended Interest Rate	Cost to WSP/P1B Borrowed (Million/Yr)
2	4.00	9.48	4:1	11.0%	190
3	4.00	15.44	4:1	9.5%	170
4	4.00	15.44	4:1	9.5%	170
5	4.56	13.46	4.56:1	9.5% CW 8.0% /PCW	170

FINDINGS AND CONCLUSIONS

I think everyone here will agree that the water sector financing requirements exceed what the government and Official Development Assistance (ODA) can provide. Hence, we need private sector financing. However we also understand that commercial bank terms of financing are not affordable to LGUs and WDs. Therefore, we believe a public-private partnership and the requisite credit enhancements are needed to meet the sector's financing requirements.

Key considerations in preparing these options are:

- The revolving fund has to leverage public sector money. If we were asking MFC for a billion pesos, we want to make sure that the billion pesos will leverage some private sector funding at substantial levels—as seen earlier, a billion could leverage about PhP15B in 15 years.
- It has to be sustainable. This means that the initial grant funds have to be repaid and the money plowed back to the fund to ensure a continuous source.
- The cost has to be affordable.
- The transactions have to be replicable. There has to be a common financing structure and terms acceptable to all parties so that projects are not structured on a deal by deal basis. We need to reconcile the interests of all parties involved in the agreement in a way that transactions can be replicated over and over again.

ANNEX 4: SUMMARY OF PROCEEDINGS OF THE WORKSHOP ON STRUCTURING OPTIONS FOR THE PHILIPPINE WATER REVOLVING FUND (HELD ON FEBRUARY 14, 2005)

In 2002, the Government of the United States Agency and Japan launched the Clean Water for People Initiative, a collaborative effort aimed at among others providing safe water supply and sanitation to the world's poor. Its goal was to accelerate international efforts to achieve the Millennium Development Goals of reducing by half the proportion of people without access to safe drinking water and sanitation by 2015. The Philippines was selected as one of the partner countries for this initiative, and the assistance was focused on establishing sustainable solutions to meet financing needs for water supply and sanitation. In pursuance thereof, the United States Agency for International Development and the Japan Bank for International Cooperation agreed to work together to develop a water revolving fund as a long term, institutionalized and sustainable approach for financing water and sanitation infrastructure.

Following a participatory approach in designing a water revolving fund, a workshop on Structuring Options for a Water Revolving Fund in the Philippines was sponsored by USAID as the forum for soliciting inputs and comments from key stakeholders. The workshop was held February 14, 2005 at the Holiday Inn Hotel, Ortigas Center, and Pasig City.

Given below is the summary of the Workshop proceedings:

The workshop commenced with welcome remarks and messages from representatives from USAID Manila, USAID Development Credit Agency and the Department of Finance. The workshop facilitator next presented the background of the workshop to establish the context and objective thereof, and to highlight the key discussion points.

This was followed by the NEDA presentation on the Philippines water supply and sanitation situation, major issues of the sector and recommendations to address these issues. This presentation underscored the need for considerable investments to meet the country's water supply and sanitation development targets as well as a number of policy and institutional reforms to improve the efficiency of services and sustainability of utility operations. The huge investment requirement underpins the establishment of a financing mechanism that leverages public with domestic private resources.

Next was the presentation on the options for the design framework of a water revolving fund. The presenter walked the participants through the rationale for establishing a water revolving fund, the fundamental structure of such a financing mechanism as adopted in the US and several other countries, the fundamental policy questions of will government provide funds and who will be the administrator of the Fund, and then discussed five options for structuring the Fund. The options were not meant to be prescriptive rather were meant to stimulate discussions among key stakeholders and policy decision makers to arrive at the most suitable structure responsive to the local situation and priorities.

The presentation was followed by plenary discussions, wherein stakeholders were encouraged to give comments and offer suggestions on how to structure the Fund. Worthy of note are the following inputs, comments and suggestions:

- There are flexibilities on the use of USAID-DCA guarantees and could be utilized creatively by the WRF.

- From the private sector viewpoint, key considerations in their participation in a WRF are: provisions to mitigate credit and term risk, profitability, mechanisms for liquidity, and credible regulatory oversight on the use and management of the fund.
- For a WRF to be successful government has to rationalize current programs financing water and sanitation infrastructure to avoid the uncoordinated use of resources and unnecessary competition between programs.
- The financing mechanism should not just cater to the big water districts, but also provide access to funds to small utilities.

Following these discussions the group agreed on the major of design considerations and the organized a Steering Committee consisting of GOP representatives (DOF as chair), the Bankers Association of the Philippines (BAP), USAID and JBIC to serve as the focal point on the final selection of the design option and the formulation of a credit framework agreement that would embody the arrangements for establishing the fund. In addition to the steering committee, a consultative group consisting of other key stakeholders will be organized to serve as the sounding board of the Committee.

The summary of agreements and next steps was followed by a presentation by JBIC of the Japanese experiences and expertise that may be tapped in the development and eventual operation of the WRF. The JBIC Chief Representative for the Manila office then gave the closing remarks.

ANNEX 5: DRAFT MEMORANDUM OF UNDERSTANDING TO ORGANIZE THE STEERING COMMITTEE FOR THE PHILIPPINE WATER REVOLVING FUND

MEMORANDUM OF UNDERSTANDING

Among

Department of Finance of the Government of the Republic of the Philippines

And

National Economic and Development Authority of the Government of the Republic of the Philippines

And

United States Agency for International Development

And

Japan Bank for International Cooperation

And

Bankers Association of the Philippines

For

Collaboration for the Creation of
A Credit Framework Agreement for

A Water Revolving Fund

In

The Republic of the Philippines

Dated March 21, 2005

MEMORANDUM OF UNDERSTANDING

This Memorandum of Understanding on the collaboration for Water Revolving Fund (WRF), referred as **Collaboration Agreement on WRF**, made and executed on this ____ day of _____ 2005 at Makati City, Philippines, by and among:

The **Department of Finance** of the Government of the Republic of the Philippines (GRP), a national government agency with its principal office at the DOF Building Central Bank Complex, Roxas Boulevard, Manila City, represented in act by its <title>, <name>, and to be hereinafter referred to as “DOF”;

The **National Economic and Development Authority** of the GRP, a national government agency with its principal office at the NEDA sa Pasig Building, Jose Ma. Escriva Avenue, Pasig City, represented in act by its <title>, <name>, and to be hereinafter referred to as “NEDA”

The **Japan Bank for International Cooperation**, a Japanese Government financial institution duly organized, existing and operating pursuant to provision of development cooperation in the Philippines by the Japanese government through yen loans, with its principal office at the 31st Floor, Citibank Tower, Valero Street corner Villar Street, Salcedo Village, Makati City, represented in this act by its Chief Representative, Mr. Osamu Murata, and to be hereinafter referred to as “JBIC”;

The **United States Agency for International Development**, a United States Government agency duly organized, existing and operating pursuant to provision of development cooperation in the Philippines by the US government, with its principal office at the 8th Floor, PNB Financial Center, 1308 Roxas Boulevard, Pasay City, represented in this act by its <title>, <name>, and to be hereinafter referred to as “USAID”;

And

The **Bankers’ Association of the Philippines**, duly organized and registered under the Securities and Exchange Commission and operating as an association of commercial banks in the Philippines, with its principal office at 11/F Sagittarius Bldg., de la Costa St, Makati City, represented in this act by <title>, <name> and to be hereinafter referred to as “BAP”.

WHEREAS:

- (a) DOF, NEDA, USAID, and JBIC, in pursuit of their development mandates, have resolved to take active roles to mobilize private funding for water supply and sanitation projects, as a priority area of concern in line with each organization’s sustainable development objectives, through a Water Revolving Fund;
- (b) The BAP is committed to the sustainable development of the Philippines through sound banking practices and financing of local infrastructure projects based on well established lending guidelines and principles;
- (c) The water needs of the Philippines can not be fully met with government resources;

- (d) Private sector financing is necessary to help address the water needs in the Philippines;
- (e) Private sector financing of local water projects is not currently affordable for most water service providers;
- (f) A public/private partnership financing program is needed that meets the needs of local water providers and the requirements of local lenders;
- (g) The creation of a WRF is recommended to establish a sustainable public/private partnership for the financing of local water projects in the Philippines;
- (h) The WRF should seek to use limited public funds to leverage private sector investments in local water projects on terms that are affordable to local water providers and reflect market rates of return for private sector lenders;
- (i) Successful implementation of a WRF will require improvements in the institutional, policy, and regulatory framework for the water sector in the Philippines and a rationalization of GRP resources for such purposes; and,
- (j) Well-packaged consulting services and technical assistance are required to develop a credible deal flow for WRF financing.

NOW THEREFORE, each party hereby agrees as follows:

Purpose: The Parties seek to establish a financing program that utilizes limited public sector resources to mobilize private sector financing of local water projects in the Philippines.

Objectives:

Through the efforts of a Steering Committee, the core group of which is composed of the Parties, and consultation among a broader group of stakeholders, the Parties will seek to establish a Credit Framework Agreement to address the following:

- (a) Capitalization of the WRF;
- (b) The ownership and management structure of the WRF;
- (c) Credit enhancement facilities for the WRF;
- (d) The operational procedures of the WRF, including but not limited to, project intake protocols, project evaluation (both technical and financial) and approval procedures, fund disbursements, post project-oversight and monitoring, and financing reporting requirements;
- (e) Standard terms and conditions of financing for all projects that will become the underwriting requirements of the WRF
- (f) Cross default and cross collateralization provisions to protect the interest of the lenders to, and the borrowers of, the WRF; and,
- (g) Deliberation of appropriate technical assistance to Local Government Units and Water Districts.

Roles and Responsibilities of Each Party:

DOF shall:

1. Serve as Chair of the Steering Committee;
2. Coordinate with all other GRP Agencies and Departments with regard to the Credit Framework Agreement and the WRF;
3. Take under consideration a sovereign loan from JBIC to partially capitalize the WRF as part of the Credit Framework Agreement; and
4. Evaluate the availability of new or existing GRP resources to credit enhance the WRF as part of the Credit Framework Agreement.

NEDA shall:

1. Participate and contribute to the discussion of the Committee on the policy framework of the WRF and its consistency with related programs of the GRP government;
2. Advise on the approval requirements of the Investment Coordinating Committee and the NEDA Board on any JBIC role in the WRF; and
3. Provide the committee with any relevant information within its jurisdiction, such as updates on the Millennium Term Philippine Development Plan (MTPDP) and the Medium Term Philippine Investment Plan (MTPIP).

BAP shall:

1. Work with member institutions to provide private sector input to the Credit Framework Agreement and the WRF; and
2. Assist as necessary in the enactment of a guarantee to a private sector financial institution through USAID's Development Credit Authority program.

USAID shall:

1. Take a leading role in the realization of the Credit Framework Agreement for the WRF;
2. Provide technical assistance to the Steering Committee in drafting and sharing the Credit Framework Agreement for the consideration of All Parties;
3. In coordination with JBIC, conduct a feasibility assessment in order to provide an analysis of the existing obstacles or missing elements that need to be addressed in the WRF;
4. Closely monitor and oversee the status and the progress of the Credit Framework Agreement; and
5. Consider the utilization of the USAID Development Credit Authority as a means to guarantee private sector components of WRF loans. Such credit guarantees would be provided to the WRF without costs to the GRP.

JBIC shall:

1. Take a role as a facilitator for the realization of Credit Framework Agreement for the WRF;
2. Assist USAID's efforts in coordinating with All Parties;
3. Upon completion of the feasibility assessment conducted by USAID, JBIC shall contemplate initiation of additional complementary studies if JBIC, in consultation with USAID, decides that such additional study is necessary; and

4. Consider making a sovereign loan to the GRP as a means of partially capitalizing, or otherwise assisting in, the establishment of the WRF.

All Parties shall:

1. Extend mutual cooperation to each other to ensure the successful conclusion of a Credit Framework Agreement;
2. Exchange information and/or views with each other with respect to any matters necessary for successful completion of the Credit Framework Agreement;
3. Consult each other at any time on any matters of common interest of All Parties;
4. Deliberate any matter in an appropriate period in order to facilitate the coordination among concerned agencies and accomplish the objectives of this MOU;
5. Discuss the contents of related technical assistance initiatives to ensure smooth implementation of a WRF program;
6. Identify a focal point of contact for all deliberations of the Steering Committee; and
7. Ensure that the Credit Framework Agreement development process benefits from the participation of and inputs from a consultative body, consisting of representatives from, but not limited to, the following:
 - a. National Anti-Poverty Commission/Office of the Power and Water Czar
 - b. Government Financing Institutions (GFIs)
 - c. LGU Guarantee Corporation (LGUGC)
 - d. Local Water and Utilities Administration (LWUA)
 - e. Philippine Association of Water Districts (PAWD)
 - f. Department of Interior and Local Government (DILG)
 - g. League of Municipalities in the Philippines (LMP)
 - h. League of Cities in the Philippines (LCP)
 - i. Cooperative Development Authority (CDA)
 - j. National Water Regulatory Board (NWRB)
 - k. Philippine Life Insurers Association of the Philippines

Signatory to this MOU does not bind any party to fund a local water project or program of projects, or bind any party to undertake any financial responsibility discussed herein.